

RECENT FINANCIAL MARKET TURMOIL



By Robert Dennis
Investment Director

After a five-year bull market, it is not surprising that the stock market is having a major correction this year but it certainly was not widely anticipated that the US would now be in the most pervasive financial crisis in a generation.

Over the past month, the Federal Reserve has taken a number of unusual precedent-setting steps

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MOTOR VEHICLE REGULAR COMPENSATION CASE SCHEDULED FOR ORAL ARGUMENT BEFORE THE SUPREME JUDICIAL COURT

By Barbara Phillips
General Counsel

In the last issue of the PERAC Pension News, we reported that the first of the motor vehicle cases to make its way through the court system was awaiting oral argument in the Supreme Judicial Court (SJC). This case involves one individual, Kenneth Pelonzi, the retired public safety commissioner and fire chief

of the City of Beverly. Mr. Pelonzi argues, as does PERAC, that the personal use of his employer-supplied motor vehicle should be included in his regular compensation for retirement purposes. Argument in the SJC has been set for April 8, 2008. The decision in this case should fully and finally resolve the issue as it relates to all retirees and active members of the retirement systems.

DISABILITY UNIT REGIONAL TRAINING SESSION SCHEDULE

The PERAC Disability Unit continues to provide regional training sessions to retirement boards. The next training sessions are scheduled for:

May 21, 2008 / 10AM-2PM / Bristol County Retirement Board, Taunton, Massachusetts

June 25, 2008 / 10AM-2PM / Worcester Senior Center, Worcester, Massachusetts

Retirement board staff members from Bristol County and the Worcester area will be given first preference for seating. Other interested parties will be registered for space available. If you are interested in attending a training session, please contact Regina Manning at 617-591-8956.

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ADDING "PREVENTION" TO FRAUD

By Sandra King
Fraud Prevention Manager
&
Frank Valeri
Deputy Director

With the recent retirement of Fraud Investigation Manager, Robert Panico, the Commission has changed the name of the Unit to the Fraud Prevention Unit and Executive Director Joseph E. Connarton has appointed Sandra King to be its new Manager.

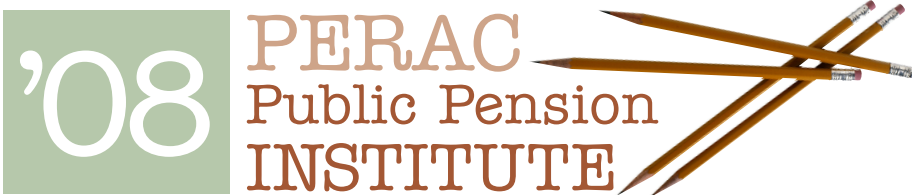
The first major undertaking of the newly organized Unit has been the issuance of the 2007 Annual Statement of Earned Income to all of the public disability retirees from Massachusetts. With the help of all retirement systems we have been able to assure compliance with the mandates imposed by the Legislature.

The Unit's goal is to ensure that the public pension plan in Massachusetts is working in accordance with the post-retirement earnings limits allowed by law. At the same time, the Unit tries to assist boards and disability retirees to better understand the current limits and requirements to which they are subject. Since the inception of the Unit, PERAC has been able to identify those disability retirees that have exceeded or abused their limits under G.L. c 32, § 91A.

Each disability retiree has received a 2007 Annual Statement of Earned Income and will be required to file it along with his/her tax forms with PERAC by April 15th. This information is utilized to identify any over-earnings and ultimately return them to the respective retirement system. In addition to putting millions of dollars back into the retirement systems, the Unit has also been able to identify those members that have not complied with the filing of the Annual Statement of Earned Income, resulting in further savings to the system.

As the Unit moves forward, we will focus more on education. The direction of the Unit is clear, according to the new Unit Manager, Sandra King, "We often receive questions from members concerning income limitations and certainly understand this area is complex for many of the retirees. My goal is to utilize the experience and knowledge in the Unit to educate retirement systems and the disability retirees on fulfilling their requirements under section 91A."

The 91A process has been added to the Disability Unit's training sessions, as well as the Public Pension Institute at UMass Amherst to be conducted later this year in August. We look forward to meeting each of you at one of the sessions and to working with you in the future.



We're looking forward to welcoming the members, administrators, and administrative personnel from all the Massachusetts public pension retirement boards to PERAC's 2008 Public Pension Institute at UMass Amherst, August 17, 18, and 19.

The Institute will feature two curriculum tracks: basic and advanced. Booklets containing detailed course descriptions, information about how to register, updated lodging information, and many other details will be mailed to the retirement boards before April 15th.

INVESTMENTS AND BASEBALL

By Robert Dennis
Investment Director

The PERAC Investment Unit's annual task of measuring the performance of Massachusetts' public retirement systems is well underway. The results to date indicate a continuation of the trends of the past several years. A number of local systems did as well as or better than the PRIT Fund in 2007, but most systems did not do as well and the composite return for the systems that invest predominantly on their own will lag that of PRIT by a significant margin.



Once again, the important point to emphasize is that the local systems, as a whole, have not performed poorly. As in the previous several years, their results are in line with median returns from several large databases of public funds. The problem in these comparisons is that the largest public funds continue to perform significantly better than smaller funds and, to their credit, PRIT continues to perform in the very top echelon of all public funds.

The advantages that large funds have are no mystery and these funds' performance differential can be seen in the results published by Wilshire's Trust Universe Comparison Service (TUCS). For all public funds in the TUCS universe, median returns for the one, three, and five-year periods ending December 31, 2007, were 7.43%, 9.03%, and 12.07%. For just those public funds with assets greater than \$1 billion, the corresponding returns were 8.70%, 10.03%, and 12.72%.

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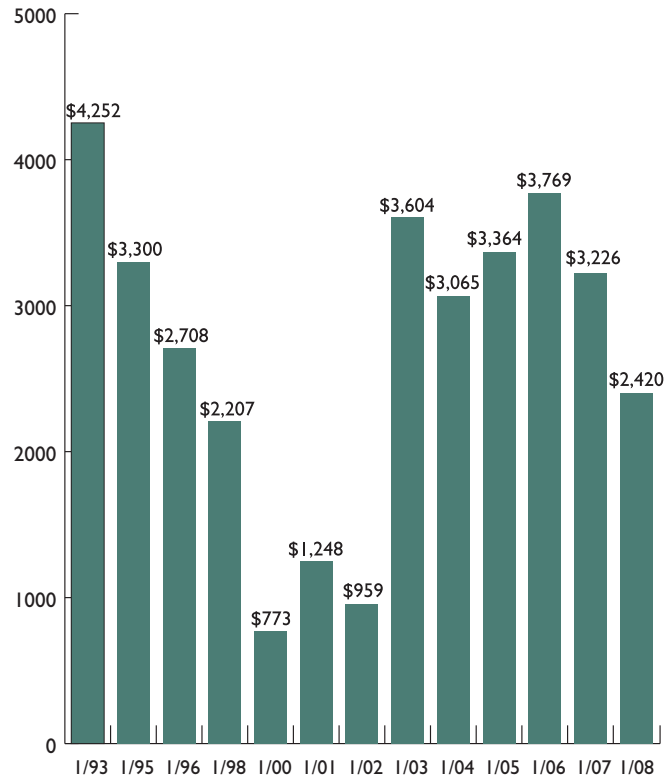
James Lamenzo
Actuary

Two charts from the January 1, 2008 actuarial valuation report of the State Retirement System (SRS) are presented on this page. The bar chart shows the unfunded actuarial liability (UAL) for the SRS since 1993. The UAL represents the actuarial accrued liability less the value of plan assets. As of January 1, 2008, the actuarial liability was \$22.8 billion and the actuarial value of plan assets was \$20.4 billion. The difference of \$2.4 billion is the UAL, which represents an \$806 million reduction from the 2007 valuation. When there is no UAL, the system is said to be fully funded.

It is important to note that plan assets have grown much faster than plan liabilities since 1993. As of January 1, 1993, the actuarial accrued liability was approximately \$9.4 billion and assets \$5.1 billion resulting in a \$4.3 billion UAL. Since 1993, the actuarial liability has grown by 2.5 times while assets have quadrupled. For this reason, the funded ratio represents a better measure of the plan's funded progress. The funded ratio equals the actuarial value of plan assets divided by the actuarial accrued liability. When the funded ratio reaches 100%, a system is fully funded. The funded ratio chart shows the significant progress made by the SRS in the past 15 years.

STATE UNFUNDED LIABILITY

(in millions of dollars)



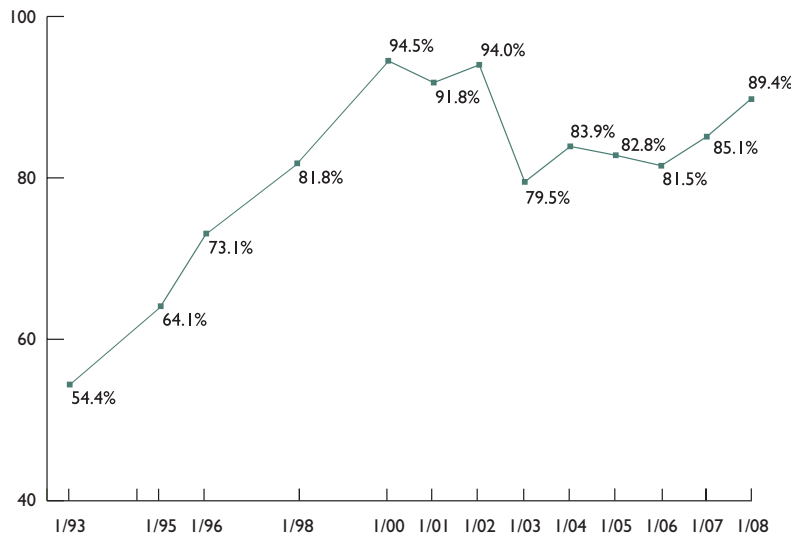
MASSACHUSETTS TEACHERS' RETIREMENT SYSTEM EXPERIENCE STUDY

James Lamenzo
Actuary

PERAC completed its second experience study of the Massachusetts Teachers' Retirement System (TRS) and published our report on February 29, 2008. This study presents the results of the Commission's experience analysis for members of TRS over the six-year period from January 1, 2000 through December 31, 2005.

This analysis does not reflect any major changes in the assumptions that have been used since our prior study was released in November 2000. The prior study covered the period from January 1, 1995 through December 31, 1999. The new study is posted in the Publications Section of PERAC's website: www.mass.gov/perac.

STATE FUNDED RATIO



2007 PERAC ANNUAL STATEMENT TRAINING SESSIONS PROVIDE A REFRESHER FOR THE CURRENT FILING SEASON

PERAC Staff Available To Help With Filing Requirements

*By Frank Valeri
Deputy Director
&
James Tivnan
Deputy Chief Auditor*

The May 1st filing deadline for all Massachusetts public retirement systems regulated by PERAC to complete and submit their Annual Statements is fast approaching. The PERAC audit staff took to the road to make presentations at several locations to try to alleviate the anxiety concerning this annual rite of spring. Early in 2008, PERAC held 4 regional training sessions, which attracted a total of 60 individuals from 50 different retirement boards. This educational approach had the added benefit of giving board staff members an opportunity to share their individual experiences and interact with their peers from other retirement boards. The regional training concept has proven to be a very effective means of fulfilling a vital component in PERAC's mission statement to provide guidance to the 106 retirement systems. Harry Chadwick, recently named PERAC's Chief Auditor, was responsible for coordinating the sessions.

The first regional training session took place on January 15th in Stoneham, at the Northeast Regional Secretaries' meeting. In addition to the Annual Statement accounting review, this session generated a spirited discussion of techniques used to deal with the practical requirements of informing retired public safety officers of insurance premiums eligible to be excluded under the provisions of the Pension Protection Act of 2006. Jim Tivnan, recently named Deputy Chief Auditor, disclosed the internal process by which PERAC assigns an auditor who is not familiar with your board to review your Annual Statement. In the case of any compliance issues related to the filing, this auditor may be the first PERAC staff member to contact you.

A second training session took place at the PERAC Somerville Office, on January 29, where Executive Director Joseph E. Connarton welcomed the attendees to the training exercise and introduced the featured speakers. All participants had the opportunity to receive a copy of the current Annual Statement Review Guidelines Checklist used by the audit staff to review Annual Statements. This document provides an excellent opportunity to view the scoring sheet actually used to analyze the completed document and serves as an excellent reference and review. These materials are available anytime upon request.

In an attempt to provide access to retirement board staff in the other areas of the state, PERAC hosted two additional training sessions. We continued our educational effort with the participation of representatives from the South Shore and Western Massachusetts. On February 5th at the Taunton Public Library and on February 7th in Northampton, the tour concluded by informing the administrators in attendance of the closing process and necessary adjustments that are included in that summary event. Harry Chadwick and Bob Madison, recently named Western Chief Auditor, conducted the Northampton session at the Clarion Inn.

In the recent past, recognizing that many administrators were familiar with the same format that has not deviated significantly from year to year, we tried a couple of different unconventional approaches to the Annual Statement training format. However, this year, we reverted to a more traditional approach by again emphasizing the debits and credits, adjusting journal entries and closing journal entries. The format and template for the filing is virtually unchanged from last year. We do now request that a date be disclosed with any amounts included on Schedule A as accounts receivable or accounts payable associated with receipts or

disbursements after the end of the calendar year. We also emphasized that interfund transfers should be included in Test #4 that measures the difference between the total debits and credits recorded during the calendar year.

The challenge for the staff has been how to make this Annual Statement training interesting and informative to the general audience that ranges from persons who have never finished an Annual Statement to persons who have completed more than 20 and could be teaching the course. Accounting information can be charitably characterized as subject matter that ranges from the dull to the repetitive and translates into a less than exciting presentation. How do we transform this into a vigorous and stimulating experience? The 2008 PERAC Educational Institute to be held at UMASS this August will provide a forum for discussing upcoming training sessions for Annual Statement training next January. In the meantime, please feel free to contact Chief Auditor Harry Chadwick with your training suggestions.

In addition to these training sessions, the boards received a CD that included an instructional guide, Preparing the Annual Statement 2007, as well as copies of the Annual Statement 2007 and the Sample Annual Statement 2007.

PERAC stands ready to provide assistance to anyone who requests it during the current filing season. A PERAC auditor will be assigned to visit your location and provide assistance during the closing process. The intent of making an auditor available to individual boards is to best ensure compliance with the May 1st filing deadline. However, this should not be construed as a substitute for support from your software/hardware vendor.

The Commission and its staff greatly appreciate your attendance and participation in these training sessions.

INVESTMENTS AND BASEBALL (continued from page 2)

Similar observations were reported for TUCS comparisons of corporate funds, foundations and endowments, and Taft-Hartley funds.

These statistics help to confirm what we've stated previously. Massachusetts local systems have, on the whole, performed satisfactorily relative to their target rates and in comparison to all public funds nationwide. However, like smaller funds in other states relative to their larger state counterparts, the local systems face significant challenges in competing with PRIM, not as a result of PERAC regulations but as a result of the inherent advantages of larger systems. As we've previously noted, the most signifi-

cant advantages lie in larger funds' ability to efficiently invest in a wide range of diversifying asset classes (several of which have enjoyed outstanding performance in recent years) and their clout which affords them hard-to-obtain access to top-tier managers in these asset classes, particularly alternative investments.

As the baseball season approaches, it is important to note that the advantages of larger public pension funds relative to smaller ones are, in a very real sense, analogous to the advantages that big market teams like the Red Sox and Yankees have relative to smaller market teams like the Royals and Rays. However, it is equally important to

note that small market teams like the Marlins and Rockies can and do rise to the top through strong organizations and good player development and acquisition, just as a number of smaller Massachusetts pension funds compete well every year against PRIT as a result of strategic asset allocation decisions and a strong roster of investment managers. Thus, just as hope springs eternal at this time of year for all major league teams, the slate starts clean for all pension systems every year. By diligently evaluating and monitoring all aspects of their investment program, all systems have a chance to pursue glory at the end of the season. Play ball!

RECENT FINANCIAL MARKET TURMOIL (continued from page 1)

aimed at shoring up the increasingly paralyzed financial system. The central bank extended credit to Wall Street brokerage firms for the first time and brokered a bailout of one of the Street's leading firms, assuming the financial risk if the mortgage-related securities it assumed from Bear Stearns were to decline further in value. In its sixth cut over the past six months, the Fed slashed the Federal Funds rate by another three quarters of a point to 2.25% on March 18 in a further dramatic step aimed at restoring confidence in the economy and in the financial markets. In another major move, the government announced on March 19 that it was relaxing the capital requirement constraints on Fannie Mae and Freddie Mac so that these government-sponsored mortgage finance agencies could provide more liquidity to the struggling mortgage market.

As *The Wall Street Journal* noted in an article entitled "Ten Days That Changed Capitalism", this period "will be remembered as the time the US government discarded a half-

century of rules to save American financial capitalism from collapse."

The demise of Bear Stearns was swift and sudden. Similar to a bank that suffered a run due to a lack of confidence by depositors, the brokerage firm essentially suffered a run by the several different types of entities with whom it did business—investors, banks, other broker-dealers, hedge funds, etc. These lenders and clients had become increasingly concerned about Bear's significant holdings of troubled, difficult-to-trade securities, including risky mortgages. This loss of confidence led these counterparties to withdraw funds and to reduce their financial relationships with Bear Stearns, bringing about an alarming decline in the firm's capital base.

From the Fed's point of view, it was not that Bear Stearns was too big to fail but that it was so interconnected to other financial entities that a sudden collapse would wreak havoc with the financial system. Thus, the Fed worked aggressively over a weekend to broker the firm's

sale to JP Morgan Chase.

Bear Stearns' stock price had been \$160 a year ago, \$87 less than three weeks earlier, and \$65 on the Wednesday before the forced sale, which was set at the shocking level of only \$2 a share. The sale price was subsequently raised to \$10. Since Bear Stearns stock was held in the portfolios of several well-respected investment managers and was also a component in the S&P 500 Index, we would expect that several Massachusetts public pension systems will share in this loss of value. (The PRIT Fund has acknowledged a holding of the stock in the portfolio of the Legg Mason Value Trust, a fund with an outstanding long-term record.) About thirty local systems have invested in S&P 500 Index funds and others may own Bear stock in actively managed accounts. However, as a result of diversification, the total portfolio impact for any affected system should be very minimal.

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Neither PRIT nor any local system had been an investment management client of Bear Stearns Asset Management, which is expected to be absorbed into JP Morgan Chase. We do not know the extent of any Massachusetts public systems' involvement in hedge funds that may use or have used Bear Stearns as their prime broker, but no disruption of service has been reported or is foreseen.

Our work in compiling the 2007 investment returns for the local retirement systems has confirmed

that no system has been impacted by measurable losses arising from holding the types of securities (such as CDOs) that have been at the forefront of the credit turmoil of the past several months.

We have not seen any actual year-to-date 2008 performance numbers from the local systems but in attempting to project these results it is once again reasonable to expect that those systems with the greatest diversification among asset classes are likely to navigate through these treacherous investment waters

with the best possible preservation of capital. Even after the market's impressive rally on March 18 and relative stabilization over the rest of the month, US stocks are off about 10% so far this year. By all accounts, asset classes like commercial real estate, hedge funds (and other "alpha" products), private equity, and real return strategies are holding up much better. A more complete report on first quarter market performance will appear in the PERAC Financial Bulletin for the first quarter.

IN MEMORIAM

Julia Lundin, Chairwoman of the Norwood Retirement System, succumbed to cancer on March 16, 2008. She had retired as the Assistant Town Accountant in June of 2007 after completing 28 years of service, but she had continued to fulfill her duties as Chairwoman of the Norwood Retirement Board up until the end. She was a public servant who was well respected and revered by all who had the occasion to cross her path. She will be missed by everyone who knew her. We extend the sincere condolences of the Commission and staff to Ms. Lundin's family and friends at this time of sorrow.